No. 11112

In The United States Court of Appeals

For the Ninth Circuit

THOMAS M. ROBINSON, Collector of Internal Revenue for the District of Montana,

Appellant

v.

ODEL ANDERSON,

Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

BRIEF FOR THE APPELLANT

H. BRIAN HOLLAND,
Assistant Attorney General

ELLIS N. SLACK,
ROBERT N. ANDERSON,
ELMER J. KELSEY,
Special Assistants to the Attorney General

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Assistant Attorney General.

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Argument:—(Continued)

CITATIONS

INDEX

Statute:

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OPINION BELOW

The opinion of the District Court (R. 22-30) is reported at 115 F. Supp. 776.

JURISDICTION

This appeal involves federal income taxes for the year 1945 in the amount of $10,292.84 which was paid by the taxpayer on November 10, 1949. (R. 32.) A claim for refund was filed on or about November 24, 1949 (R. 7), and was rejected by notice dated April 14, 1950 (R. 32). Within the time provided in Section 3772 of the Internal

Revenue Code and on September 8, 1950, the taxpayer brought this action in the District Court for recovery of the taxes paid. (R. 11.) Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1340. The case was tried by the Court without a jury. (R. 34.) The judgment was entered on June 30, 1953. (R. 35.) Within sixty days and on August 27, 1953, a notice of appeal was filed. (R. 35-36.) Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

QUESTION PRESENTED

Whether the finding of the District Court, that for federal income tax purposes the taxpayer, his wife, and two minor sons, were joined together as a partnership for the present conduct of the Anderson ranch during the tax year 1945, is clearly erroneous.

STATUTE AND RULE INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. (26 U. S. C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U. S. C. 1946 ed., Sec. 182.)

FEDERAL RULES OF CIVIL PROCEDURE:

RULE 52. FINDINGS BY THE COURT

(a) *Effect.* * * * Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses. * * *

STATEMENT

The facts, as taken from the uncontroverted evidence, may be summarized as follows:

Prior to 1935 the Anderson ranch, located in Chouteau County, Montana, was owned and operated by A. E. Anderson, the father of the taxpayer, Noel Anderson. (R. 40-41.) Sometime in 1935 the taxpayer and his father formed a partnership for the operation of the ranch under the name of A. E. Anderson and Son. (R. 42-43.) This partnership continued until the death of the father on Christmas Eve, 1943. (R. 41-43.)

The taxpayer's mother was appointed administratrix of the father's estate (R. 137) and during 1944 the ranch

was operated under the name, A. E. Anderson and Son, pursuant to an agreement between the taxpayer, his mother and sister, the sole distributees of the father's estate (R. 62).

During the lifetime of the father all the property of the partnership including its bank account, had been held in the name of the father, A. E. Anderson. (R. 43.) After the father's death, the taxpayer opened a new bank account in the name of A. E. Anderson and Son on which only he could draw checks. (R. 49-50, Ex. 38, Appendix, *infra.*)

As the former partner of his father in A. E. Anderson and Son, the taxpayer claimed a one-half interest in the Anderson ranch and as one of the three distributees of his father's estate he was entitled to an additional one-third of the other half of the Anderson ranch and one-third of all other property, including the Kingsbury Ranch, which the father had owned apart from the partnership. (R. 48-49, 56-59.)

Sometime in 1944, the taxpayer made an agreement with his mother and sister to purchase their respective interests in his father's estate. (R. 55, 61-63.) This agreement could not be consummated until the spring of 1946 when the estate was ready to be closed. (R. 62.)

In discussions in December 1944 between the taxpayer, his wife, Agnes Anderson, and his son, Robert Anderson, it was orally agreed that a partnership should be formed for the operation of the entire ranch properties. (R. 60-61.) This agreement was subsequently assented to by the taxpayer's son, Noel Junior Anderson,

when he was home from the Army on a furlough in January, 1945. (R. 68, 219.) It had been previously discussed with the taxpayer's tax attorney. (R. 53-55.)

By this agreement the taxpayer and his wife were each to have a one-third interest in the partnership and each of the two boys, Noel Junior, age 19 (R. 229), and Robert, age 18 (R. 236), were to receive an one-sixth interest (R. 60-61, 219-220). The interests of the boys were valued at $7,500 each (R. 248) and were to be paid from the accumulation of their shares of the earnings of the partnership (R. 141, 219-220). The boys were not to receive deeds of their shares until the $7,500 had been completely paid from the earnings. (R. 106, 250.) Meanwhile they were to be given their necessary expenses for support and education. (R. 234-235, 264.) It was stated that the partnership was to commence January 1, 1945. (R. 201.) There was no mention of any consideration to be given by the wife for her one-third share. (R. 60-61, 199-200.)

Prior to 1945 both boys, when home from school or college, worked on the ranch and the wife helped with the cooking and minor farm chores. (R. 45-46, 136, 196.) After 1938 the family lived at the ranch only during the summer months and lived in Fort Benton, Montana, the remainder of the year in order to permit the boys to attend school. (R. 135, 208-209.) Hired help were also employed to do the work of the ranch. (R. 135, 195, 209.) Since about 1940 the taxpayer had known that he suffered from heart trouble and subsequently refrained from heavy work. (R. 51, 253-254, 262.)

The younger son, Robert, attended Montana State College, at Bozeman, for four academic years, 1944-1948, where he majored in industrial engineering. (R. 240.) The elder son, Noel Junior, attended the same college during the school year 1943-1944. (R. 230.) On September 19, 1944, he enlisted in the United States Army and was not discharged until January, 1946. (R. 218-220, 232-233.) In September of 1946 he returned to college and remained there for the school year 1946-1947. (R. 221-222.)

During the entire year, 1945, the elder son, Noel Junor Anderson, was in the military service and thus contributed no services to the running of the ranch (R. 52, 220-221), although he was credited on the account books kept by the taxpayer with, and there was reported in his income tax returns for that year, a full one-sixth of the earnings of the partnership (R. 97, 228, 233-234). During that year the son, Robert, worked on the ranch during the summer vacation from college and for a few days during the branding of livestock in May. (R. 71-72, 241-242.)

Taxpayer testified that his purposes in forming the partnership were to save federal income taxes by splitting the ranch income between the members of his family, and to offer his sons an opportunity to obtain something more than wages for their work. (R. 136-137.)

During the year 1945 all business of the ranch with third persons was conducted in the name of A. E. Anderson & Son, the old partnership, or of Noel Anderson, personally, and no such business was conducted in the name of the alleged new partnership, Noel Anderson &

Sons. (R. 113, 153, 167-168.) During 1945 no bank account existed in the name of Noel Anderson & Sons and such a bank account was not opened until May of 1946. (R. 75, 111-112.) All receipts from sales of livestock and grain from the ranch were deposited in the bank account of A. E. Anderson & Son, the old partnership (R. 75, 156), on which only the taxpayer could draw checks (Ex. 38).

During the year 1945 all the real and personal property of the ranch remained in the record name of the deceased father, A. E. Anderson. (R. 149-150, 155.) Property taxes on all the ranch properties were assessed against A. E. Anderson during the year 1945 and were paid by checks of the taxpayer drawn on the A. E. Anderson & Son bank account. (R. 155, 279-280.) Contracts with Government agencies with respect to conservation projects on the ranch were executed and completed in the name of A. E. Anderson and Son by the taxpayer; none were carried on in the name of the alleged partnership Noel Anderson & Sons. (R. 153-154, 282-290.)

All dealings in wheat and livestock derived from the ranch during 1945 were handled in the name of A. E. Anderson, the deceased father, or A. E. Anderson and Son, the old partnership, none in the name of the alleged new partnership, Noel Anderson & Sons. (R. 113, 150-151, 172-175, 296.) In fact the cattle brands, which were recorded in the name of A. E. Anderson, were not transferred to Noel Anderson & Sons until sometime in 1951. (R. 149-150.)

None of the various purchases of equipment for the ranch in 1945 were made in the name of the alleged new partnership Noel Anderson & Sons. (R. 172-175.)

A considerable portion of the land which constituted the ranch was leased from the State of Montana in the name of the father, A. E. Anderson. These leases were not transferred to the new partnership, Noel Anderson & Son, until 1947. (R. 163-166.)

On October 13, 1945, insurance was written for 15,000 bushels of grain in the name of the taxpayer as the assured, and the premium was paid from the joint bank account of the taxpayer and his wife. (R. 271-277. Ex. 41, Appendix, *infra.*)

The taxpayer kept a cash book of the receipts and expenses of the ranch and an informal ledger showing the status of the interests of the members of the family. (R. 69, 78, 92-100.) These records were not entirely complete (R. 100) and do not bear the name of the alleged partnership (R. 93-94).

In January, 1946, an income tax return for the year 1945 was filed by the taxpayer in behalf of the alleged partnership, Noel Anderson & Sons. (R. 108-110.) At the same time individual returns showing distributive shares of the ranch income were filed in behalf of the boys, Noel, Jr., and Robert, and the wife, Agnes. (R. 108-110.) The returns of the sons were signed in their behalf by the taxpayer, and the taxes on their shares were paid by checks drawn by the taxpayer on his joint bank account with his wife. (R. 144-145.)

Later, in May and June of 1946, the purchase by the taxpayer of the interests of the mother and sister in his father's estate was concluded by their giving deeds of their interests to him in return for the payment by him of approximately $9,000 to each. (R. 63-65, 139-140.) These payments were made partially from the joint bank account of taxpayer and his wife and partially from the bank account of the partnership, Noel Anderson & Sons. (R. 63, 65.) Subsequently, in August, 1946, the assets of the estate of the father, including the Kingsbury ranch which had not been a part of the assets of the prior partnership, A. E. Anderson & Son, were distributed to the taxpayer by a decree of the Probate Court. (R. 67.)

On the audit of the tax returns for 1945, the Internal Revenue Agent reported that no valid partnership for tax purposes existed in that year and, accordingly, that all of the income from the Anderson ranch should be taxed to the taxpayer, Noel Anderson, and none to his wife and sons. (R. 32.)[1] The deficiency resulting from this determination, in the amount of $10,292.84, was paid by the taxpayer on November 10, 1949. (R. 32.) A claim for refund was filed about November 24, 1949 (R. 7) and was rejected by the Commissioner about April 14, 1950 (R. 32). This suit was commenced September 8, 1950. (R. 11.)

The interests of the sons in the partnership, Noel Anderson & Sons were fully paid from the earnings of the

[1] Other adjustments to which the taxpayer agreed resulted in the exclusion from the partnership's return of a certain income which should have been reported by the former partnership, A. E. Anderson and Son. (R. 74-77.)

partnership by sometime in 1950 (R. 102) and deeds of their one-sixth interest in the partnership, executed by the taxpayer and his wife, were given to them on May 15, 1951 (R. 105-107), subsequent to the institution of this suit. At the same time the taxpayer deeded a one-third interest to his wife. (R. 104.)

The District Court, without a jury (R. 34), determined that during the year 1945 the taxpayer, his wife and both sons had been joined together in a valid partnership recognizable for federal income tax purposes (R. 33), and adjudged that the taxpayer was entitled to a refund of the $10,292.84 which he had paid to the Collector (R. 34-35). This appeal in behalf of the Collector followed. (R. 35-36.)

STATEMENT OF POINTS TO BE URGED

1. The finding of the District Court that the taxpayer, Noel Anderson, his wife, Agnes Anderson, and their two sons, Robert M. and Noel J. Anderson, in good faith and acting with a business purpose, were joined together for the tax year 1945 in the present conduct of the Anderson ranch as a partnership for federal income tax purposes was clearly erroneous.

2. The trial court erred in finding that the Collector erroneously and illegally collected from the taxpayer the sum of $10,282.84 for 1945.

SUMMARY OF ARGUMENT

The District Court's finding that the alleged partnership actually existed during 1945 is clearly erroneous. The agreement between the parties contemplated the formation of a partnership at some later date and not for it to exist during that year. The conduct of the parties was also inconsistent with the existence of a partnership in 1945 since all the business of the Anderson ranch was conducted under other names than the alleged partnership. Furthermore, the existence of the partnership in 1945 was impossible because title to the assets of the ranch had not been acquired by any of the parties. In any event the taxpayer retained such complete dominion and control over the property of the enterprise during 1945 that the income therefrom should be taxed to him in its entirety. Furthermore, the son, Noel Junior Anderson, should not be recognized as a partner because he was absent from the ranch and in the military service during the entire year and contributed neither capital nor services to the enterprise during 1945. Likewise, the wife should not be recognized as a partner because no business purpose existed in making her such, and she contributed neither capital nor services to the enterprise during 1945.

ARGUMENT

THE DISTRICT COURT'S FINDING THAT A VALID PARTNERSHIP FOR TAX PURPOSES EXISTED DURING 1945 BETWEEN THE TAXPAYER, HIS WIFE, AND HIS TWO SONS IS CLEARLY ERRONEOUS.

A. *In order for the income to be taxed to the alleged members, the partnership must have existed during the tax year, 1945.*

The controlling principle as set forth in *Commissioner* v. *Culbertson,* 337 U. S. 733, is whether "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise" as a partnership during the tax year involved. Thus, as stated in *Culbertson* (p. 742):

> The question is * * * whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent—the parties in good faith and acting with a business purpose intended to join together in the *present conduct* of the enterprise. (Emphasis added.)

In holding that a partnership must exist during tax year, in order to be recognized for federal income tax purposes for that year, and that an agreement to form a partnership in the future will not suffice, the Supreme Court said (p. 740):

> Furthermore, our decision in *Commissioner* v. *Tower, supra,* clearly indicates the importance of participation in the business by the partners during the tax year. We there said that a partnership is created "when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and loses." *Id.* at 286. This is, after all, but the application of an often iterated definition of income—the gain derived from capital, from labor, or from both combined—to a particular form of business organization. A partnership is, in other words, an organization for the production of income to which each partner contributes one or both of the ingredients of income—capital or services. *Ward* v. *Thompson,* 22 How. 330, 334 (1859). The intent to provide money, goods, labor, or skill sometime in the future cannot meet the demands of Secs. 11 and 22 (a) of the Code that he who presently earns the income through his own labor and skill and the utilization of his own capital be taxed therefor. The vagaries of human experience preclude reliance upon even good faith intent as to future conduct as a basis for the present taxation of income.

This is merely an application of the general rule that, irrespective of the effect of local law upon a transaction, the federal income tax laws tax income to the person whose labor or capital was responsible for its production in the tax year. *Lucas* v. *Earl,* 281 U. S. 111; *Helvering* v. *Clifford,* 309 U. S. 331.

The principles of the *Culbertson* case have been applied by this Court in a number of cases, including *Wisdom* v. *United States,* 205 F. 2d 30; *Parker* v. *Anderson,* 186 F.

2d 49, *Toor v. Westover,* 200 F. 2d 713, certiorari denied, 345 U. S. 975; and *Harkness* v. *Commissioner,* 193 F. 2d 655, certiorari denied, 343 U. S. 945.

Harkness v. *Commissioner,* supra, is very similar to the present case. There, the taxpayer, who had been the sole owner of a business, entered into a written partnership agreement with his wife, son and daughter. The agreement by its terms was to become effective January 1, 1943. During the taxable year 1943 both the son (who was in the Army) and the daughter were out of the state and could not have been expected to and did not render any services to the partnership. The taxpayer's purpose in forming the partnership was, as here, (1) to obtain the future services of his children and (2) to obtain advantage of splitting his income for tax purposes. On these facts this Court approved the determination of the Tax Court that no partnership, recognizable for federal income tax purposes, had been in operation during the year 1943, and, at most, the parties had made a contract to create a partnership at later date.

In giving effect to the statements of the Supreme Court in the *Culbertson* case quoted *supra,* this Court, in the *Harkness* case, said (p. 658):

> But the crucial question was whether the new arrangement was really and truly to begin at once, or at some future date, when the desired help of the young men would become available. The Tax Court expressed no doubt of a good faith intent to create a partnership *at some time.* The evidence of what the son and son-in-law did in later years would tend to confirm such an intent. But it would not tend to

> prove intent *presently* to join in the enterprise. What the Tax Court found was that what existed was "an indefinite future plan to operate United Packing Co. as a genuine partnership," and that the Harkness children "were not bona fide partners in 1943."

The *Culbertson* and the *Harkness* cases, *supra,* make it abundantly clear that a crucial question in every case is whether the asserted partnership arrangement was really and truly intended to begin at once or whether it was to begin at some future time. An intent to form a partnership at a future time, when, herein for example, Noel Junior would be home from the Armed Service, Robert would be home from college, and Mrs. Anderson, Noel Junior and Robert would have earned their respective interests in the family ranch so that they could make a contribution to capital, and when probate of the Estate of A. E. Anderson was finally settled, is not sufficient to satisfy the requirements of intent *presently* to join in the conduct of the partnership enterprise in 1945. There is no evidence in the record of this case, other than interested statements of members of the family of what they intended, to prove present action in 1945 as a partnership. Good faith intent to form a partnership in the future is not enough.

Although the agreement in this case may have been legally binding under Montana law for the division of income, the issue in this case is whether a partnership existed in 1945, in good faith and with a business purpose, for the joint operation of the Anderson ranch, so that it may be said that the shares of the income allocated to the wife and children were not merely earned by the father,

the taxpayer, and given to them under the agreement, but were actually earned in that year by the children and wife.

B. *The agreement was to form a partnership in the future, not during 1945.*

As recollected by the parties who testified at the hearing, the family arrangement, as orally agreed upon in December, 1944, and January, 1945, was that the interests in the proposed partnership were to be divided as follows:—one-third to the taxpayer, one-third to his wife and one-sixth to each of the two sons. The sons were to receive their interests when paid for out of the accumulation of their shares of the earnings. (R. 60-61, 106, 219-220, 226.) The sons actually did not fully pay for their shares until 1950 (R. 102) and did not receive conveyances of their interests until May 1951, subsequent to this suit. (R. 105, 250), at which time the wife also received a conveyance of her interest (R. 104).

There was no present transfer of any interest to the sons and wife in 1945, only an agreement by the taxpayer to transfer such interests in the future when the conditions of the agreement had been fulfilled. The sons, in 1945, gave no notes or anything of value for their prospective interests in the partnership, nor did they obligate themselves in any way to render services or pay in the future for their interests. Either of the boys could have abandoned the project without incurring any liability for the payment of their proposed shares in the partnership. Thus, the situation here is different from that presented in other decided cases in which there were docu-

mented complete transfers of interests in a partnership by a taxpayer to members of his family in return for cash, contributions of capital, or promissory nots of the other parties. *Culbertson* v. *Commissioner,* 194 F. 2d 581 (C. A. 5th) after remand by the Supreme Court; *Seabrook* v. *Commissioner,* 196 F. 2d 322 (C. A. 5th); *Commissioner* v. *Western Construction Co.,* 191 F. 2d 401 (C. A. 9th); *Goold* v. *Commissioner,* 182 F. 2d 573 (C. A. 9th); *Green* v. *Arnold,* 87 F. Supp. 255 (N. D. Tex.), affirmed *per curiam,* 186 F. 2d 18 (C. A. 5th).

That present partnership was not contemplated is further indicated by a consideration of the circumstances of the sons at the time the agreement was discussed. Noel Junior was in the Army and on his way to the Pacific theater of the war. He could not estimate when he would be released and be able to return to the ranch. (R. 218-220, 232-233.) Robert had just commenced four years of study at Montana State College in Bozeman (R. 240) and could not be expected to contribute anything, except summer work, during those four years.

The District Court erred in relying upon the services rendered by the sons in 1944, prior to the taxable year involved here, as capital contributions rendered to the partnership. (R. 23, 31.) These services, which were nothing more than work normally done by sons of a rancher (R. 136) and to which the taxpayer, as parent, was entitled by Montana law (*Gilman* v. *G. W. Dart Hardware Co.,* 42 Mont. 96, 111 Pac. 550), were not considered in the agreement of the parties as contributions to the proposed partnership (R. 60-61, 219-220). Also, since at the time the services were performed the partnership had not been

discussed, they could not have been rendered in contemplation thereof.[2]

As stated, the wife did not receive a conveyance of her proposed one-third interest in the partnership until May, 1951, subsequent to this suit, and at the same time as the taxpayer conveyed interests to the sons. (R. 104-106.) The only evidence which tends to show any capital contribution by the wife to the partnership was that the taxpayer drew a check in 1946 on the bank account in which she had a joint interest to pay his mother and sister for their interests in the properties of the ranch. (R. 63-65.) This payment in 1946 corroborates the fact that the agreement did not contemplate the formation of the partnership in 1945.

The District Court erred in relying upon work performed by the wife as being her contribution to the partnership. (R. 28, 31.) This work was not recognized in the proposed partnership agreement (R. 60-61, 219-220) and, in any event, was not of a "vital" nature (R. 196-197). *Commissioner* v. *Culbertson,* 337 U. S. 733, 743.

The terms of the agreement, according to the testimony of the parties and their subsequent conduct, disclose that it was not intended that a partnership, should exist in

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[2] In its opinion and findings of fact the District Court said that the proposed partnership was discussed and planned by the taxpayer's family in the month of April 1944. (R 25, 31.) This finding is unsupported by the record. April 1944 was never mentioned in the testimony of the members of the Anderson family and the only reference to it appears in the partnership income tax return filed for 1945 which is in dispute in this case. The record shows that the taxpayer first discussed the formation of the partnership with his tax attorney in October 1944 and that other discussions followed in December 1944 and January 1945. (R. 53-55, 60-61, 68.)

1945. The brief answers of the interested parties to questions of their counsel that the partnership commenced on January 1, 1945 (R. 201, 220, 251) should not be understood literally in view of the other evidence in the record, outlined *supra*, to the contrary. An express provision in the written partnership agreement in the *Harkness* case, *supra*, that a partnership was to commence on January 1, 1943, was held not to be determinative in view of the evidence in that case that the actual intention was otherwise.

Of course, under Rule 52(a) of the Federal Rules of Civil Procedure, *supra*, the District Court's finding that a partnership for federal income tax purposes existed during 1945 among the members of the Anderson family should not be set aside unless clearly erroneous, and due regard should be given to the opportunity of the trial court to judge the credibility of the witnesses. However, such a finding is never conclusive and—

> * * * is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with a definite and firm conviction that a mistake has been committed.

United States v. *Gypsum Co.*, 333 U. S. 364, 395; *Bjornson* v. *Alaska S. S. Co.*, 193 F. 2d 433 (C. A. 9th); *Pacific Portland Cement Co.* v. *Food Mach. & Chem. Corp.*, 178 F. 2d 541 (C. A. 9th). In this case, despite the unsupported statements of the interested parties that the partnership existed in 1945, we believe that the overwhelming evidence to the contrary is sufficient to show that a mistake was committed by the District Court.

C. *The formation of the partnership was impossible during 1945 because the taxpayer had not acquired the ranch properties.*

That the partnership did not exist in 1945 is proved by the evidence that it was impossible for it to exist in that year. The taxpayer could not have conveyed any partnership interest to his wife or sons in 1945 because he did not then have title to all the ranch property. (R. 61-62.) In 1945 the estate of his father, in whose name the title to all the ranch properties was held (R. 43), was still open with his mother as administratrix, and himself, his mother and sister as distributees (R. 62). The assets of his father's estate included the Kingsbury ranch in addition to the original Anderson ranch in which the taxpayer claimed a one-half interest as the former partner of his father. (R. 46-47.) The taxpayer did not acquire title to all of the ranch properties which were to go into the new partnership until the spring and summer of 1946 when he purchased and obtained conveyances from his mother and sisters of their interest in the property and his father's estate was finally distributed to him. (R. 62-65, 67.)

D. *The conduct of the parties was inconsistent with the existence of a partnership in 1945.*

One of the important circumstances to be considered in determining whether a partnership existed in a given year is the conduct of the parties. *Commissioner* v. *Culbertson,* 337 U. S. 733, 742-743; *Goold* v. *Commissioner,* 182 F. 2d 573, 575 (C. A. 9th).

In this case the taxpayer and the other parties did not reveal by their conduct and dealings with third parties in 1945 that the alleged partnership existed. All transactions during that year concerning the Anderson ranch were conducted in the name of the former partnership, A. E. Anderson and Son, or by the taxpayer personally; none were conducted in the name of the alleged partnership, Noel Anderson & Sons. (R. 113, 153, 167-168.) The bank account remained in the name of A. E. Anderson and Son throughout the year and until May 1946. (R. 75, 111-112.) On this account the taxpayer alone could draw checks. (Ex. 38.)

Livestock and wheat were sold in the name of A. E. Anderson and Son, the old partnership. (R. 113, 150-151, 296-297.) Title to the ranch property including the property leased from the State of Montana remained in the name of the father, A. E. Anderson, throughout the year. (R. 155, 163-166.) The state leases were not transferred to the new partnership, Noel Anderson & Sons, until 1947. (R. 163-166.) The cattle brands were not assigned to the new partnership until 1951. (R. 149-150.) Real estate taxes were paid by A. E. Anderson and Son, the old partnership (R. 155), and conservation contracts with federal agencies were entered into during the year 1945, not in the name of the alleged partnership, Noel Anderson & Sons, but in the name of the former partnership, A. E. Anderson and Son, by Noel Anderson (R. 153-154, 282-290). In the rather extensive record there is not one instance of any dealing in the year 1945 with any third party by the alleged partnership, Noel Anderson & Sons.

The Disrtict Court relied on the evidence that, although there were no transactions in 1945 by Noel Anderson & Sons, all transactions with respect to the Anderson ranch were charged or credited to the accounts of that partnership. (R. 25-26.) These accounts, however, do not bear the name of the alleged partnership (R. 93-94) and were kept personally by the taxpayer with a view to income tax purposes (R. 93, 97, 100). It was admitted that the entries with respect to the status of the interests of the partners were not made until sometime in 1946 and were taken from the tax returns which are in dispute in this case. (R. 97, 99.) The new equipment purchased for the Anderson ranch was not entered as additional capital in these books, which would have been necessary to reflect the actual capital position of the alleged partners, because, as the taxpayer stated, such entries are not made on the tax returns. (R. 100.) Consequently, these books are insufficient evidence that the partnership actually and in good faith existed in 1945.

No disinterested witness was able to testify that he had dealt with, or ever heard of the existence of, the alleged partnership, Noel Anderson & Sons, in 1945, although some had had numerous dealings with members of the Anderson family with respect to the business of the ranch. (R. 172-175, 178-193, 290-303.) According to the *Culbertson* case, 337 U. S. 733, 742, the testimony of such disinterested persons is an important factor in ascertaining whether or not a partnership existed during the tax year.

E. *The taxpayer retained such dominion and control over the property and earnings during 1945 that the income should be taxed to him.*

A partnership is not recognized for tax purposes if one party retains, during the tax year, such dominion and control over the property and earnings that, in view of all the circumstances and as a practical matter, the income should be taxed as his. *Commissioner* v. *Culbertson*, 337 U. S. 733, 747-748; *Helvering* v. *Clifford*, 309 U. S. 331.

In *Toor* v. *Westover*, 200 F. 2d 713, this Court held that a partnership recognizable for tax purposes had not been created when the transferor of a partnership interest had retained many incidents of ownership. This Court concluded in that case (p. 714):

> We conclude that the retention by the donor of so many incidents customarily identified with ownership precluded the donee from becoming the substantial owner of a partnership interest which would entitle the partnership to recognition for tax purposes.

In the present case the taxpayer retained such complete control and dominion over the alleged interests in the partnership of his wife and sons that all the income therefrom in 1945 should be taxed to him under the rule laid down in the cases mentioned above.

The sons, age 19 and 18, respectively (R. 229, 236), were not entitled to draw their earnings from the partnership but received only such sums as the taxpayer might give them for their support and education (R. 234-235, 264). These sums, he, as a parent, was under duty to

provide anyway (*Lay* v. *District Court*, 122 Mont. 61, 198 P. 2d 761), and the partnership agreement made no difference in these amounts. During the year the son, Noel Junior Anderson, actually received none because he was absent in the Army (R. 94-95, Ex. 12-I, Appendix, *infra*), and Robert was given only college expense money in the total sum of only $855 (R. 264, Ex. 12-A, 12-J, Appendix *infra*) out of their respective earnings of $5,741.38 each, as credited upon the alleged books of the partnership (Exs. 12-I, 12-J).

As to the wife there is no proof that she actually was paid any of the earnings. (Ex. 12, R. 99, 211.)

The taxpayer kept the records (R. 99, 249-250) and only he could draw checks on the bank account in which the funds of the enterprise were deposited (Ex. 38).

The taxpayer made all the major policy decisions for the operation of the ranch during 1945. Noel Junior could not have participated because he was absent in the Army (R. 52, 220-221) and Robert, because of youth, deferred to the wishes of his father (R. 263-264).

The absence of realty to the partnership during 1945 is dramatized by the fact that the taxpayer had the income tax returns for 1945 prepared in behalf of his sons, signed by himself, and paid the taxes reported therein from his personal bank account. (R. 144-145.)

Whatever surface changes the alleged partnership agreement may have made in the operation of the Anderson ranch enterprise, the evidence shows that it did not disturb in the least during 1945 the taxpayer's dominion and control over the property or the purposes for which

the income from the ranch property was used. The taxpayer was able, in other words, during that year, irrespective of the agreement, to retain the full enjoyment of all the rights which previously had accrued to him from the property. The situation is similar to that commented upon in the *Clifford* case, p. 336, and *Culbertson* case, pp. 746-747. In the latter case it was said (pp. 746-747):

> It is hard to imagine that respondent felt himself the poorer after this [partnership agreement] had been executed or, if he did, that it had any rational foundation in fact.

Therefore, since the taxpayer actually was responsible for the creation of the income during the taxable year it should be taxed to him and not be permitted to be split among the members of his family by reason of the alleged agreement. *Lucas* v. *Earl,* 281 U. S. 111; *Helvering* v. *Clifford,* 309 U. S. 331

The taxpayer's retention of control over all the earnings of the partnership, we submit, confirms our position that the parties did not intend that the partnership should commence during the year 1945.

F. *The son, Noel Junior Anderson, was not a partner for tax purposes during 1945 because he was absent in the Army during the entire year and contributed neither capital nor services to the enterprise.*

It is obvious that the District Court clearly erred in holding that the son, Noel Junior Anderson, was a valid member of the alleged partnership during the taxable year. It was admitted that this son was away in the

Army until January 1946, and consequently, rendered no services to the enterprise, in 1945. (R. 52, 220-221.) The partnership agreement did not provide for his contributing any capital and he contributed none. (R. 141, 219-220.) One-sixth of the earnings of the ranch during the year 1945 were credited to him upon the records kept by the taxpayer and was reported as income to him upon the tax returns prepared in his behalf by the taxpayer. (R. 108-110.)

With respect to Noel Junior, this case is clearly one where the taxpayer is attempting to violate the well accepted principle that income can only be taxed to the person who furnished the capital or services from which it was produced, irrespective of arrangements and agreements for the division of the income with other persons. *Lucas* v. *Earl*, 281 U. S. 111; *Helvering* v. *Clifford*, 309 U. S. 331.

The situation as to Noel Junior is nearly identical with the facts presented to the Supreme Court in *Commissioner* v. *Culbertson*, 337 U. S. 733, and to this Court in *Harkness* v. *Commissioner*, 193 F. 2d 655. In both of those cases, as in the present one, an attempt was made to have a son recognized as a partner for tax purposes, who was absent during the pertinent tax years by reason of service in the military establishment, rendered no services during the year and contributed no capital. In both cases it was held that the son could not be recognized as a valid partner for income tax purposes.[3]

[3] Upon remand, however, of the *Culbertson* case, the Fifth Circuit determined as a matter of fact that the son there involved had made a capital contribution to that partnership, *Culbertson* v. *Commissioner*, 194 F. 2d 581.:

In *Commissioner* v. *Culbertson, supra,* which was followed by this Court in the *Harkness* v. *Commissioner, supra,* the Supreme Court said (pp. 739-740):

> * * * If it is conceded that some of the partners contributed neither capital nor services to the partnership during the tax years in question, as the Court of Appeals was apparently willing to do in the present case, it can hardly be contended that they are in any way responsible for the production of income during those years. The partnership sections of the Code are, of course, geared to the sections relating to taxation of individual income, since no tax is imposed upon partnership income as such. To hold that "Individuals carrying on business in partnership" includes persons who contribute nothing during the tax period would violate the first principle of income taxation: that income must be taxed to him who earns it. *Lucas* v. *Earl,* 281 U. S. 111 (1930); *Helvering* v. *Clifford,* 309 U. S. 331 (1940); *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422 (1949).

With respect to the military service of the alleged partner in the *Culbertson* case, the Supreme Court said in a footnote on page 739:

> Of course one who has been a bona fide partner does not lose that status when he is called into military or government service, and the Commissioner has not so contended. On the other hand, one hardly becomes a partner in the conventional sense merely because he might have done so had he not been called.

The District Court relied upon the work performed by the son, prior to his going into the military service and

after he returned therefrom, as contributions to the partnership. (R. 28-29.) Any work Noel Junior may have performed prior to the date of the formation of the alleged partnership cannot, of course, be considered a contribution to the partnership. Likewise, work performed subsequent to the taxable year is immaterial because, as we have shown above, the income tax is assessed upon income earned during the taxable year, not income derived from work in either prior or subsequent years. *Ginsburg* v. *Arnold,* 175 F. 2d 879 (C. A. 5th).

The District Court also clearly erred in stating that the other son, Robert, had substituted for Noel Junior during 1945. (R. 23.) Such a substitution was not proved because it was not shown that the work performed by Robert was not in his personal capacity. Furthermore, such a substitution cannot be recognized for tax purposes because it would result in taxing the income obtained from the work performed by Robert as income to Noel Junior which is prohibited by the principles stated previously, namely, that, for income tax purposes, transfers of income will not be recognized, and income must be taxed to the person who earns it. *Lucas* v. *Earl,* 281 U. S. 111.

G. *The finding of the District Court that the wife was a partner for federal income tax purposes during 1945 was clearly erroneous since there was no business purpose involved in making her a partner.*

The court below also clearly erred in finding that the wife was a partner during the year 1945. As stated in

Commissioner v. *Culbertson*, 337 U. S. 733, 742-743, the criteria for determining whether a partnership existed for federal income tax purposes is whether—

> * * * the parties in good faith and *acting with a business purpose* intended to join together in the present conduct of the enterprise. (Emphasis added.)

There is no evidence in the record that any business purpose was served by making the wife a partner. The taxpayer stated that his purpose in forming the partnership was to give his sons something better than wages and thus to retain their services on the ranch, as well as to take advantage taxwise of the splitting of the ranch income among the members of the family. (R. 136-137.) There is, however, no evidence as to the purpose for making the wife a partner, other than tax avoidance. It was not even intimated that the agreement was necessary in order for the taxpayer to retain the services of his wife, such as they were.

Furthermore, the proof shows that there was no change in the nature and extent of the services the wife rendered before and after the agreement. (R. 45-46, 136, 196.) The work the wife performed both before and after the agreement was no more extensive or different in nature than that normally performed by the wife of a rancher in the circumstances of the Anderson family. The services consisted, the evidence shows, of housework and minor farm errands and chores. (R. 45-46, 136, 196.)

There was no provision in the alleged partnership agreement for the wife to contribute capital. (R. 60-61,

200, 219-220.) It is immaterial that the taxpayer paid his mother and sister for their interests in the ranch assets by drawing checks in 1946 on the joint account he held with his wife for such contribution of capital by the wife, if it is to be considered such, was not until after the close of the taxable year here involved.

CONCLUSION

It is apparent that no valid partnership existed in the instant case for tax purposes during the taxable year involved. The decision of the District Court is clearly erroneous. It should be reversed and the cause remanded with instructions to enter judgment in favor of the Collector.

Respectfully submitted,

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Assistant Attorney General.

Ellis N. Slack,
Robert N. Anderson,
Elmer J. Kelsey,
Special Assistants to the Attorney General.

Krest Cyr,
United States Attorney.
March, 1954

APPENDIX

EXHIBIT 12-A

Page 1

Robert Anderson 1945

Jan.	2	Check	75.00
	29	Check	55.00
Feb.	15	Check	50.00
Mar.	1	"	55.00
	26	"	90.00
May	1	"	100.00
	21	"	20.00
July	11	Check	20.00
	3	"	20.00
Aug.	11	"	20.00
Sep.	21	"	350.00
			855.00

* * * * *

EXHIBIT 12-H

Noel and Agnes Anderson

P. 58

1945 1945 Partnership Earnings

Aug. 23 Dep. wht. sales 18,483.62

Noel Anderson $11,482.77

Agnes Anderson 11,482.77

* * * * *

EXHIBIT 12-I

Page 60

Noel J. Anderson

Jan. 1, 1945 Share in Partnership.....7500.00

1945 Partnership Earnings.....5741.38

* * * * *

EXHIBIT 12-J

Page 62

Robert M. Anderson

Jan. 1, 1945 Share in Partnership.....7500.00

1945 Partnership Earnings.....5741.38

Cash drawn p. 1..... 855.00

EXHIBIT 38

STIPULATION

With the understanding that evidence not inconsistent herewith may be introduced by either of the litigants, IT IS HEREBY STIPULATED AND AGREED that the following bank accounts were the only accounts found to exist in the Chouteau County Bank, Fort Benton, Montana, in the names of the following:

A. E. Anderson and Son—Opened February 10, 1944. Noel Anderson authorized to sign checks.

Noel Anderson and Sons—Account opened April 30, 1946. Noel Anderson Sr. and Agnes Anderson (his wife) are the only persons certified to sign checks.

Noel Anderson and Agnes A. Anderson—Joint personal account between husband and wife opened December 1, 1941. Both persons mentioned authorized to sign checks.

Noel J. Anderson (son)—Account opened January 30, 1946. This is the personal account of Noel (son) and he is the only person authorized to sign checks.

Robert M. Anderson (son)—Account opened December 19, 1949. This is the personal account of Robert (son) and he is the only person authorized to sign checks.

The opening entry to the credit of the account of Noel Anderson and Sons was a credit entry of $13,064.00, of which $12,939.30 was carried over from the account of A. E. Anderson and Son when the latter account was closed out April 30, 1946. The carry over from the account of A. E. Anderson and Son, together with a small Treasury Check deposited to the credit of Noel Anderson and Sons,

accounts for the $13,064.00 opening credit to the latter account.

DATED this 12th day of December, 1952.

* * * * *

EXHIBIT 41

ASSURED'S LEDGER-LINE RECORD
Date—October 13, 1945
Assured—Noel Anderson Paid
Fort Benton, Montana 11/1/45

For Insurance as Follows:

Expiration	Policy No.	Company	Kind of Insurance	Property Covered	Amount	Rate	Premium Due
10-30-46	83835	Rky Mt	Fire	Grain in Storage	15,000	.75	112.50

THANKS

Property Covered

Policy mailed 10-13-45.